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Washington, DC 20548

October 5, 2009

The Honorable Solomon Ortiz
Chairman
Subcommittee on Readiness
Committee on Armed Services
United States House of Representatives

Subject: Briefing on Air Force's Response on Fee-For-Service Aerial Refueling

Section 1081 of the National Defense Authorization Act for Fiscal Year 2008 calls for the Secretary of the Air Force to conduct a pilot program to assess the feasibility and advisability of utilizing commercial fee-for-service air refueling tanker aircraft for Air Force operations.¹ In response to your May 2009 letter to the Secretary of the Air Force requesting an update on the status of this pilot program, the Air Force submitted the Status of the Pilot Program on Commercial Fee-For-Service Air Refueling Support for the Air Force on August 7, 2009.

This letter formally transmits the enclosed briefing in response to your May 2009 request requiring GAO to provide the Subcommittee an assessment of the information in the Air Force update and any recommendations regarding the fee-for-service air refueling pilot program that may be appropriate. The full briefing, including our scope and methodology, is reprinted as Enclosure 1. As part of our quality assurance protocol, we obtained comments on the briefing from DOD and incorporated those comments as appropriate.

This report will also be made available at no charge on GAO's Web site at <https://gao.gov>. Should you or your staff have any questions concerning this report, please contact me at (202) 512-8365 or solisw@gao.gov. Contact points for our Office of Congressional Relations and Public Affairs may be found on the last page of this

¹ Section 1081 of the National Defense Authorization Act for Fiscal Year 2008, Pub. L. No. 110-181, January 28, 2008.

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report. Key contributors to this report were Ann Borseth, Assistant Director; Charles Perdue, Assistant Director; Noah Bleicher; Laura Czohara; Stephanie Gaines; Joanne Landesman; John Van Schaik; and Stephen Woods.

A handwritten signature in black ink, appearing to read 'W. Solis', with a long horizontal flourish extending to the right.

William M. Solis
Director, Defense Capabilities and Management

Enclosure

Enclosure: Briefing Slides



GAO REVIEW OF THE AIR FORCE COMMERCIAL FEE-FOR-SERVICE AIR REFUELING PILOT PROGRAM

Observations on Status Report

**Briefing for the Staff of the
House Committee on Armed Services,
Subcommittee on Readiness**

September 11, 2009



Briefing Outline

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- Background
 - Objectives, Scope, Methodology
 - Observations on Fee-for-Service Air Refueling Pilot Program



Background

- Section 1081 of the National Defense Authorization Act for FY 2008 (Public Law 110-181) calls for the Secretary of the Air Force to conduct a five year pilot program to evaluate the feasibility and advisability of fee-for-service air refueling to support, augment, or enhance the air refueling mission of the Air Force by utilizing commercial air refueling providers on a fee-for-service basis.
 - Additionally, Section 1081 mandates GAO submit to the congressional defense committees (1) an annual review of the conduct of the pilot program and any recommendations for improving the program and (2) a final assessment of the results of the pilot program and recommendations for whether the Secretary of the Air Force should continue to utilize fee-for-service air refueling.
- On May 7, 2009, the House Committee on Armed Services, Subcommittee on Readiness, requested that the Secretary of the Air Force submit, no later than July 30, 2009, a report to include the current status of the fee-for-service air refueling pilot program, the additional steps needed to implement the pilot, and information regarding the cost of conducting the pilot program from the planning phase through the five year period required in the legislation.
- The Subcommittee also requested GAO to assess the Air Force's status report on the fee-for-service air refueling pilot program no later than 60 days after the date on which the Secretary of the Air Force submits the report. The Air Force report was submitted Aug. 7, 2009.



Background (continued)

- Air refueling occurs using two methods: flying boom or probe and drogue
 - Boom in-flight air refueling is accomplished by the Boom Operator, flying the tanker's refueling boom into the receiver's receptacle. Once connected, the tanker pumps fuel from its fuel tanks into the receiver's fuel tanks. This is the primary method used by the Air Force.
 - Probe and drogue air refueling is accomplished by a probe-equipped receiver flying the receiver aircraft's probe into the tanker's drogue — a basket attached to the end of a flexible hose or the tankers boom. Once connected, the tanker transfers fuel to the receiver aircraft. This is the method used by the Navy.
- There are no commercial boom-equipped refueling aircrafts.
- The Air Force gathered data from two Requests For Information (RFIs) and hosted two sets of Industry Days to help inform what would be necessary for a successful pilot program, to develop cost estimates, and to gain insight concerning the status of the industry today.
- According to the Air Force's response, entitled *Status of the Pilot Program on Commercial Fee-For-Service Air Refueling Support for the Air Force*, potential participants in the pilot program will need time to acquire a boom and modify an aircraft. The fee-for-service air refueling pilot program anticipates an 18 to 36 month preparatory period during which a boom-equipped air refueling aircraft will be developed. Air Mobility Command will then conduct the pilot program over the five year service period required by law.



Background (continued)

Based on Air Force assessment of information gathered at Industry Days, two models are likely to emerge for the pilot program because, according to the Air Force, the new aircraft will have to be certified airworthy (either by the Federal Aviation Administration (FAA) or the Air Force) and because various vendors will likely compete under their preferred model of certification of airworthiness.

Aircraft in the Pilot Program could operate under two models:

Model 1: *Air Force would be the airworthiness certification authority*

Model 2: *FAA would be the airworthiness certification authority*

The Pilot Program would be structured under two options:

Option 1: Two Vendors, Four Aircraft (Two Aircraft each)

- One vendor with Air Force certification; and
- One vendor with FAA certification

Option 2: One Vendor, Two Aircraft

- Single certification (either FAA or AF certification)



Objectives

Key objectives of our engagement describe

- (1) whether the Air Force response addresses the elements as requested by the House Committee on Armed Services, Subcommittee on Readiness; and
 - (2) any additional information relating to the Fee-for- Service (FFS) Air Refueling pilot program that could further inform congressional defense committees.
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Scope and Methodology

Scope

- Office of Assistant Secretary of the Air Force (Acquisition) Global Reach Programs (SAF/AQQ), Rosslyn, VA
- Office of Assistant Secretary of Defense, Acquisition, Technology and Logistics, Defense Procurement and Acquisition Policy, the Pentagon
- Air Force Acquisition, Program Executive Office for Combat and Mission Support, the Pentagon
- Air Force Materiel Command, Aeronautical Systems Center, Wright Patterson Air Force Base, Ohio
- Air Force Air Mobility Command, Scott Air Force Base, Illinois

Methodology

- We reviewed Section 1081 of the National Defense Authorization Act for FY 2008 (Public Law 110-181), the Air Force's response, entitled *Status of the Pilot Program on Commercial Fee-For-Service Air Refueling Support for the Air Force* as well as DOD and Air Force policy and guidance, including Department of Defense Instruction 5000.02, Enclosure 9, and Air Force Instruction 63-101.
- We interviewed officials to gain an understanding of the Fee-For-Service Air Refueling Pilot Program, including cost estimates, the requirements generation process, legislative relief identified by the Air Force, and the review and approval process for the acquisition of services, specifically those designated "Special Interest".
- We conducted our work from June to September 2009 in accordance with all sections of GAO's Quality Assurance Framework that are relevant to our objectives. The framework requires that we plan and perform the engagement to obtain sufficient and appropriate evidence to meet our stated objectives and to discuss any limitations in our work.



GAO Review of the Air Force Response

- The Air Force response, *Status of the Pilot Program on Commercial Fee-For-Service Air Refueling Support for the Air Force*, addresses the elements as requested by the House Committee on Armed Services, Subcommittee on Readiness.
- We found additional information that could further inform the Subcommittee about the pilot program in the areas of costs, legislative relief, and service contract requirements.



Observations on the Air Force Commercial Fee-For-Service Air Refueling Pilot Program

Cost

- Total costs of the FFS Air Refueling pilot program are uncertain but are likely to be significant.
 - Cost figures for the FFS Air Refueling pilot program range from:
 - \$2B (the initial estimate based on preliminary data gathered from the first RFI as well as the first round of Industry Days, February-April 2008) to
 - \$1.3B (as estimated from more detailed data gathered from the second RFI as well as the second round of Industry Days and based upon further cost analysis, February 2009). According to Air Force officials and GAO analysis, this estimate is based on detailed cost estimating (including government support costs for developing RFP as well as standing up a program office, and service period costs such as certification costs) to
 - \$850M-\$900M (as reported in the Air Force response, *Status of the Pilot Program on Commercial Fee-For-Service Air Refueling Support for the Air Force*.
- (Note: According to Air Force officials, cost estimates are in constant FY09 dollars. Therefore, the estimates do not account for inflation).



Observations on the Air Force Commercial Fee-For-Service Air Refueling Pilot Program

Impact of Amortization

- It is important to note how the application of amortization costs impacts the cost per flying hour.
 - For example, the Air Force response states that the “Air National Guard...could provide an additional 4,800 hours of air refueling per year for \$43 million per year”. This equates to a cost of about \$8,960 per flying hour.
 - According to Air Force officials, there are no amortization costs built into the flying hour cost portion of the \$43 million per year because the aircraft (KC-135) has been fully amortized.
- According to GAO analysis, the cost of a long term Fee-for-Service Air Refueling Pilot Program would mean lower vendor flying hour costs because the amortization costs would be spread over a longer period of time than just the five year pilot period.
- Additionally, the AF is mandated to report annually on the fee-for-service air refueling program, including information on, among other things, the annual and cumulative cost to the Government of the program, including a comparison of costs of the same service provided by the Air Force.



Observations on the Air Force Commercial Fee-For-Service Air Refueling Pilot Program

Legislative Issues

The Air Force response identified legislative changes it believes are necessary to begin the pilot program. According to the Air Force, the following require legislative authority:

- *Legislative authority to award a multiyear services contract*
 - According to the Air Force, a multiyear contract is necessary to assist vendors' ability to secure financing, reduce program costs, and increase competition.
 - Aerial Refueling is not one of the covered services authorized for multiyear contracting in 10 U.S.C. § 2306c(b). Therefore, any multiyear contract for these services would require legislation authorizing the contract.
- *Legislative authority to award an 8-year multiyear contract*
 - FFS AR pilot program executed in two phases – preparatory (boom development and test for 1.5-3 years) and service (five year pilot program).
 - The law authorizes certain multiyear services contracts for not more than five years. Therefore, a contract for longer than five years would require legislation authorizing the contract.
- *Legislative authority to award a multiyear contract valued at more than \$500M*
 - If the value of the multiyear contract is to exceed \$500M, authority for the contract must be specifically provided by law, in accordance with 10 U.S.C. § 2306c(d)(2).



Observations on the Air Force Commercial Fee-For-Service Air Refueling Pilot Program

Legislative Issues Continued

The Air Force response identified additional legislative changes it says are necessary to award a multiyear contract for the Fee-For-Service Aerial Refueling pilot program:

- The Air Force identified the need for authority to award a multiyear contract with an unfunded contingent liability in excess of \$20M.
 - Existing multiyear contract authority requires congressional defense committee notification of a contract for services that includes an unfunded contingent liability in excess of \$20M. 10 U.S.C § 2306c(d)(1).
- The Air Force identified the need for authority to award a multiyear contract with a cancellation ceiling in excess of \$100M.
 - Existing multiyear contract authority requires congressional defense committee notification of a contract for services that has a cancellation ceiling in excess of \$100M. 10 U.S.C. § 2306c(d)(4).



Observations on the Air Force Commercial Fee-For-Service Air Refueling Pilot Program

Legislative Issues

Additionally, the Air Force response identified other areas that it says require legislative action:

- *Relief from funding for contract cancellation costs*
 - Under current law, if the budget for a multiyear contract does not include proposed funding for contract cancellation up to the cancellation ceiling of the contract, the agency head must provide congressional defense committees a financial risk assessment of not budgeting for cancellation costs, including the cancellation ceiling amounts for each contract year. 10 U.S.C. § 2306c(d)(5).
 - Air Force says cancellation costs will be substantial during preparatory period and decrease annually.
- *Relief from a requirement to certify that contracting for the service is the most cost-effective means of obtaining the service*
- *The Air Force anticipates that potential vendors will seek indemnification under Public Law 85-804 for potential tort liability to third parties for personal injury or property damage resulting from aerial refueling operations.*
 - Instead, the Air Force recommends that Congress authorize government insurance for the service providers under 49 U.S.C. Chapter 443.



Observations on the Air Force Commercial Fee-For-Service Air Refueling Pilot Program

Review and Approval Process for Service Acquisitions

- In February 2009, OSD AT&L published guidance on review criteria for the acquisition of services, specifically stating that AT&L will review and approve all proposed acquisitions for services over \$1B as well as those categorized as "Special Interest".
- According to Air Force and OSD officials, service acquisitions that are less than \$1B, but are complex, have high congressional interest, and entail a large commitment of resources, may warrant a "Special Interest" designation.
- According to the OSD guidance, this designation entails specific oversight procedures, including the review and approval of the acquisition strategy as well as a peer review panel, which involves the Director of the Defense Procurement, Acquisition Policy and Strategic Sourcing.
- As of August 2009, the Air Force Fee-For-Service Air Refueling pilot program has not been designated "Special Interest". However, according to both the Air Force response as well as Air Force and OSD officials, this pilot program is anticipated to be designated "Special Interest". According to OSD AT&L, review and approval of the acquisition strategy would occur prior to the issuance of a draft Request for Proposal.
- According to an OSD official, because the Fee-For-Service Air Refueling pilot program has been legislatively required, it is unclear what impact this designation would have in the pre-award period.

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